APPENDIX A

Internal Revenue Code:

CHAPTER 1—INCOME TAX

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SEC. 112. Recognition Of Gain Or Loss.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

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(5) [as amended by Section 213 (c) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. Where the transferee assumes a liability of a transferor,

or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under subsection (k) it is not to be considered as "other property or money") shall be considered as stock or securities received by such transferor.

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(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

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(26 U.S.C. 1946 ed., Sec. 112.)

CHAPTER 2—Addition Income Tax

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Subchapter E—Excess Profits Tax

[As added by Section 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974, which provided that the new subchapter may be cited as the "Excess Profits Tax Act of 1940"]

Part I

Sec. 710. Imposition Of Tax.

(a) *Imposition.*—There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1939, on the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax as follows:

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(b) *Definition of Adjusted Excess Profits Net Income.*—As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) *Specific exemption.*—A specific exemption of $5,000;

(2) *Excess profits credit.*—The amount of the excess profits credit allowed under Section 712; and

(3) *Unused excess profits credit.*— * * *

(26 U.S.C. 1946 ed., Sec. 710.)

Sec. 711. Excess Profits Net Income.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a) (2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments shall be as follows:

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(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

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(26 U.S.C. 1946 ed., Sec. 711.)

Sec. 712 [as amended by Section 13 of the Excess Profits Tax Amendments of 1941, c. 10, 55 Stat. 17,[1] and by Section 228 (e) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798].

[1] By Section 17 of the Excess Profits Tax Amendments of 1941, the amendments made by that Act were made effective as of the date of the enactment of the Excess Profits Tax Act of 1940.

Excess Profits Credit-Allowance.

(a) *Domestic Corporations.*—In the case of a domestic corporation which was in existence before January 1, 1940, the excess profits credit for any taxable year shall be an amount computed under section 713 or section 714, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed. In the case of all other domestic corporations the excess profits credit for any taxable year shall be an amount computed under section 714. (For allowance of excess profits credit in the case of certain reorganizations of corporations, see section 741.)

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(d) *Special Rule in Connection With Certain Reorganizations.*—For the existence of taxpayer through component corporation, see section 740 (f).
(26 U.S.C. 1946 ed., Sec. 712.)

Sec. 713 [as amended by Section 4 of the Excess Profits Tax Amendments of 1941, *supra*, and by Sections 215 and 228 of the Revenue Act of 1942, *supra*]. Excess Profits Credit—Based On Income.

(a) *Amount of Excess Profits Credit.*—The excess profits credit for any taxable year, computed under this section shall be—

(1) *Domestic corporations.*—In the case of a domestic corporation—

(A) 95 per centum of the average base period net income,

(B) Plus 8 per centum of the net capital addition as defined in subsection (g), or

(C) Minus 6 per centum of the net capital reduction as defined in subsection (g).

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(b) Base Period.—

(1) *Definition.*—As used in this section the term "base period"—

(A) If the corporation was in existence during the whole of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the period commencing with the beginning of its first taxable year beginning after December 31, 1935, and ending with the close of its last taxable year beginning before January 1, 1940; and

(B) In the case of a corporation which was in existence during only part of the forty-eight months preceding the beginning of its first taxable year under this subchapter, means the

forty-eight months preceding the beginning of its first taxable year under this subchapter.

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(e) *Average Base Period Net Income—General Average.*—The average base period net income determined under this subsection shall be determined as follows:

(1) By computing the aggregate of the excess profits net income for each of the taxable years of the taxpayer in the base period, reduced by the sum of the deficits in excess profits net income for each of such years. If the excess profits net income (or deficit in excess profits net income) for one taxable year in the base period divided by the number of months in such taxable year is less than 75 per centum of the aggregate of the excess profits net income (reduced by deficits in excess profits net income) for the other taxable years in the taxpayer's base period divided by the number of months in such other taxable years (herein called "average monthly amount") the amount used for such one year under this paragraph shall be 75 per centum of the average monthly amount multiplied by the number of months in such one year, and the year increased under this sentence shall be the year the increase in which will produce the highest average base period net inome;

(2) By dividing the amount ascertained under paragraph (1) by the total number of months in all such taxable years; and

(3) By multiplying the amount ascertained under paragraph (2) by twelve.

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(26 U.S.C. 1946 ed., Sec. 713.)

Sec. 714. Excess Profits Credit—Based On Invested Capital.

The excess profits credit, for any taxable year, computed under this section, shall be the amount equal to 8 per centum of the taxpayer's invested capital for the taxable year, determined under section 715.[2]

(26 U.S.C. 1946 ed., Sec. 714.)

Part II—Rules In Connection With Certain Exchanges

Supplement A—Excess Profits Credit Based on Income

Sec. 740 [as amended by Section 228 (a) of the Revenue Act of 1942].

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[2] The percentage of the credit was variously modified, by reductions on a graduated basis, by amendments to Section 714 of the Code made, successively, by Section 201 (b) of the Revenue Act of 1941, c. 412, 55 Stat. 687 Section 217 of the Revenue Act of 1942, *supra*, and Section 205 of the Revenue Act of 1943, c. 63, 58 Stat. 21.

Definitions.

For the purposes of this Supplement—

(a) *Acquiring Corporation.*—The term "acquiring corporation" means

(1) A corporation which has acquired—

* * * * *

(D) substantially all the properties of a partnership in exchange to which section 112(b)(5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5), or to which a corresponding provision of a prior revenue law, is or was applicable.

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(b) *Component Corporation.*—The term "component corporation" means

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(5) In the case of a transaction specified in subsection (a) (1) (D), the partnership whose properties were acquired.

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(g) *Component Corporations of Component Corporations.*—If a corporation is a component corporation of an acquiring corporation, under subsection (b) or under this subsection, it shall (except for the purposes of section 742 (d) (1) and (2) and section 743 (a) (1), (2), and (3)) also be a component corporation of the corpora-

tion of which such acquiring corporation is a component corporation.[3]

(h) *Sole Proprietorship.*—For the purpose of sections 740 (a) (1) (D), 740 (b) (5), and 742 (g), a business owned by a sole proprietorship shall be considered a partnership.
(26 U.S.C. 1946 ed., Sec. 740.)

Sec. 742 [as amended by Section 228 (c) of the Revenue Act of 1942]. Supplement A Average Base Period Net Income.

In the case of a taxpayer which is an acquiring corporation, its average base period net income (for the purpose of the credit computed under section 713) shall be the amount computed under section 713 or the amount of its Supplement A average base period net income, whichever is the greater. The Supplement A average base period net income shall be the amount computed without regard to subsection (h) of this section or computed under subsection (h) of this section, whichever is the greater. The Supplement A average base period net income shall be computed as follows:

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(g) In the case of a partnership which is a component corporation by virtue of section 740

[3] The provisions referred to in the parenthetical clause in Sec. 740 (g) are not relevant to the question in this case.

(b) (5), the computations required by this Supplement shall be made, under rules and regulations prescribed by the Commissioner with the approval of the Secretary, as if such partnership had been a corporation. For the purpose of such computations, in making the adjustment for income taxes required by section 711 (b) (1) (A), the partnership so regarded as a corporation shall be considered as having distributed all its net income as a dividend.

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(26 U.S.C. 1946 ed., Sec. 742.)

Treasury Regulations 111 (relating to the Income Tax), promulgated under the Internal Revenue Code:

Sec. 29.111 (b) (5)-1. *Transfer of Property to Corporation Controlled by Transferor.*—As used in section 112 (b) (5), the phrase "one or more persons" includes individuals, trusts or estates, partnerships and corporations (see section 3797); and to be in "control" of the transferee corporation such person or persons must own immediately after the transfer stock possessing at least 80 percent of the total combined voting power of all clases of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of such corporation. (See section 112 (h).) The phrase "immediately after the exchange" does not necessarily require simultaneous exchanges by

two or more persons, but comprehends a situation where the rights of the parties have been previously defined and the execution of the agreement proceeds with an expedition consistent with orderly procedure.

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Sec. 29.112 (h)-1. *Control of Corporation.*—Section 112 (h) defines the term "control" in reference to the phrase "control of the corporation," as used in section 112 (b) (5) and section 112 (g) (1). It is provided specifically that this definition is limited to the meaning of the term "control" as that term is used in section 112.

Treasury Regulations 112 (relating to the Excess Profits Tax), promulgated under the Internal Revenue Code:

Sec. 35.740-1 *Purpose and Scope of Supplement A.*—(a) The term "Supplement A", when used in these regulations, mean sections 740 and 742 to 744. Supplement A provides rules governing the right to use the excess profits credit based on income and the method of computing such credit, in the case of certain "acquiring" corporations. An acquiring corporation is a domestic corporation which has absorbed one or more other domestic corporations, partnerships, or businesses owned by sole proprietorships in a transaction meeting the requirements set forth in section 140 (a), which

transaction is generally referred to in these regulations as a "Supplement A transaction." Each such absorbed corporation, partnership, or business owned by a sole proprietorship is designated a component corporation of the acquiring corporation. Furthermore, except for the purposes of section 742 (d) (1) and (2) and section 743 (a) (1), (2) and (3), if an acquiring corporation is later absorbed by another acquiring corporation, all of the component corporations of the first acquiring corporation become component corporations of the second acquiring corporation. * * *

(b) The purpose of Supplement A is in general to attribute to an acquiring corporation the existence of corporations, partnerships, or businesses owned by sole proprietorships absorbed by it, together with the base period excess profits net income or deficit in excess profits net income and the net capital changes of such predecessors, in order (1) that a corporation the corporate life of which in substance, though not in form, includes the base period may use the excess profits credit based on income and (2) that a corporation composed in whole or in part of component corporations may compute its excess profits credit in the light of the base period experience of the entire enterprise. * * *

Sec. 35.740-2 *Transactions Whereby a Corporation Becomes an Acquiring Corporation.*— (a) The types of transactions whereby a cor-

poration can become an acquiring corporation are specifically described in section 740 (a). In addition to statutory mergers and consolidations and the acquisition of property in a complete liquidation in which gain or loss is not recognized because of the provisions of section 112 (b) (6) or the same section as contained in the Revenue Act of 1936 or 1938, only the following types of transactions are included.

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(4) The acquisition of substantially all the properties of a partnership in an exchange to which section 112 (b) (5), or so much of section 112 (c) or (e) as refers to section 112 (b) (5), or to which the corresponding provisions of a prior revenue law, is or was applicable. For the purposes of this paragraph a business owned by a sole proprietorship shall be considered a partnership.

(b) The types of transactions set forth in section 740 (a), other than those set forth in section 740 (a) (1) (C), either are embraced within the definition of a reorganization contained in section 112 (g) (1), are transfers to a controlled corporation within the meaning of section 112 (b) (5) and related sections, or are complete liquidations within the meaning of section 112 (b) (6). Since Supplement A applies only to cases where there is a sufficient continuity of interest to justify treating a corporation by which the assets of another cor-

poration, a partnership, or a business owned by a sole proprietorship have been acquired, as standing in the place of its predecessor, such transactions must satisfy all the requirements of the regulations prescribed under section 112 with respect to such transactions in order that the transferee corporation may be treated as an acquiring corporation.

Sec. 35.740-4 *Partnerships and Sole Proprietorships Under Supplement A.*—A partnership (or a business owned by a sole proprietorship) can be a component corporation for the purposes of Supplement A, subject to the exceptions in section 740 (g). However, a partnership (or a business owned by a sole proprietorship) cannot be an acquiring corporation and, therefore, section 740 (g) cannot operate to make any of its predecessors component corporations of its acquiring corporation.

Sec. 35.742-1 *General Rules for Determining Supplement A Average Base Period Net Income.*—(a) *Introductory.*—In the case of an acquiring corporation which was actually in existence before January 1, 1940, its average base period net income, for the purposes of the excess profits credit based on income, shall be (1) the amount computed under section 713 with reference to its base period experience but without reference to the base period experience of its component corporations; or (2) the

amount of its Supplement A average base period net income, computed under section 742 with reference to its base period experience and also with reference to the base period experience of its component corporations, which ever of such amounts is the greater. * * *

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(b) *General average method.*—(1) *In General.*— * * *

(2) *Determination of excess profits net income or deficit in excess profits net income of acquiring corporation and each component corporation.*—The first step in computing the average base period net income of an acquiring corporation is the determination of the excess profits net income or deficit in excess profits net income of the acquiring corporation and each component corporation for each taxable year beginning with or within a base period year of the acquiring corporation. * * *

In the case of a component corporation which is a partnership or a business owned by a sole proprietorship, its excess profits net income or deficit in excess profits net income for each taxable year in the base period shall be determined as though such partnership or business owned by a sole proprietorship had been a corporation for each such year. Among the adjustments which are necessary in computing the excess

profits net income or deficit in excess profits net income are the following:

(i) A reasonable deduction for salary or compensation to each partner or the sole proprietor for personal services actually rendered shall be allowed;

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